indemnification to the amount of the individual entry(ies) being reversed.

FMS proposes to add a new Sec. 210.6(g) to address the Federal Government's initiation of reversals. Under proposed Sec. 210.4(b), a recipient who executes an authorization agrees, among other things, that the Federal Government may reverse duplicate or erroneous entries or files, as provided in proposed Sec. 210.6(g).

The NACHA Rules permit an originator to reverse duplicate or erroneous entries and permit an ODFI, originator, or originating ACH Operator to reverse duplicate or erroneous files within five banking days of the settlement date of the duplicate or erroneous file or entry. For purposes of the NACHA Rules (and under proposed Part 210), a duplicate entry is an entry that is a duplicate of an entry previously initiated by the originator or ODFI. An erroneous entry is an entry that orders payment to or from a receiver not intended to be credited or debited by the originator or that orders payment in a dollar amount different that what was intended by the originator.

Under the NACHA Rules, the ODFI and/or originating ACH Operator indemnify the RDFI against any losses the RDFI incurs as a result of effecting a reversal. Consequently, in the event that the RDFI reverses an entry or file initiated by the ODFI, but the RDFI cannot recover the amount of the entry from the receiver (because, for example, the receiver has withdrawn the funds and closed the account), it is the ODFI or originator who bears the loss.

The Social Security Administration (SSA) reports suffering losses of $1-2 million annually due to misdirected payments. SSA has expressed concern that, as the number of Direct Deposit payments dramatically increases, additional millions could be misdirected as a result of data entry errors. The ability to effect reversals is an important way in which the Federal Government can reduce losses resulting from overpayments and misdirected entries. If a reversal is effected expeditiously, in many cases the receiver may not be aware that the erroneous or duplicate entry occurred, and thus the funds may be available in the account for recovery by the RDFI and, ultimately, the Federal Government.

With respect to certain types of payments, however, the Federal Government's ability to reverse a duplicate payment or overpayment to a recipient may be constrained due to the existence of various Federal statutory provisions governing the manner in which the Federal Government may recover overpayments. For example, in the context of Federal benefit payments, the Federal Government may be required to provide a notice and hearing prior to taking action to recover payments, or may be limited in the amount, timing or manner in which an overpayment is recovered. FMS is not proposing to address the operation of these requirements in Part 210 because the applicable requirements may vary depending on the type of the payment. It is the agency's responsibility to determine before certifying a reversal that the reversal will not violate any applicable laws or regulations.

The 1994 NPRM addressed reversals in the context of recipient authorizations: By executing an

authorization, a recipient agreed that the Federal Government reserved the right to use reversal entries in the event that it originated duplicate files or entries in error. Several commenters on the 1994 NPRM requested clarification as to whether the Federal Government, when initiating reversals, would be bound by the NACHA Rules that generally apply with respect to reversals, such as the five (5) day reversal deadline. As stated in this NPRM, FMS has indicated its intention that all ACH Rule requirements would apply to Federal Government-initiated reversals, except that the extent of the Federal Government's indemnification would be limited to the amount of the entry(ies). The proposed rule would clarify this point.

NACHA Response: Notwithstanding FMS' expressed concern as to whether Federal agencies may be able to effect reversals related, for example, to overpayments within the 5-banking day window established by the NACHA Rules, FMS has elected, in proposed section 210.6(g), to bind Federal agencies to this requirement. However, since reversals are addressed in both subsections (e) and (g) of this section 210.6, we believe FMS should also clarify in subsection (e) that the 5-banking day window applies.

We also believe that FMS should clarify its intent with respect to Federal agencies certifying compliance to FMS under proposed section 210.6(g) as to how this provision affects the indemnification of the RDFI and other parties to a transaction as provided under NACHA Operating Rule 2.4.5. It appears that the proposed rule, by only addressing certification to FMS (which is addressed as a warranty under the NACHA Rules), may ignore these other parties.

Moreover, subsection (e) raises a substantive issue in that it would impose an amorphous responsibility and potential loss on an RDFI should it fail "to follow standard commercial practices in processing the [original] entry[ies]." Given that the proposal specifically intends to shift a portion of the risk of loss to the RDFI in cases where an agency effects a reversal by introducing a comparative negligence standard, FMS' acceptance of the time limit on initiating reversals may not be meaningful. This is particularly so in the case of erroneous entries.

Further, subsection (g) references reversals of "entries" by "agencies" (a defined term) and "files" by the "Federal Government" (an undefined term). Setting aside any rationale for this distinction, a separate question arises from pairing the source of the original files with that of the reversing file if the source is in fact different.

Finally, NACHA would call to the attention of FMS a recent change to the NACHA Rules, effective December 1997, that requires the reversing party to notify the receiver no later than the settlement date of the reversal.

Account Requirements for Benefit Payments [proposed Sec. 210.5].
Proposed Part 210 would impose a requirement with respect to ACH credit entries representing

benefit payments that is not imposed under the NACHA Rules, i.e., that such payments be deposited to an account at a financial institution "in the name of" the recipient, with two exceptions: (1) use of an "authorized payment agent" or (2) an investment account. The term "account" for purposes of proposed Sec. 210.5 is intended to mean a deposit account and not a loan account or general ledger account. In this regard, FMS addresses specifically a change to the NACHA Rules which will become effective in March 1999 to permit the crediting of ACH credits to a financial institution general ledger account or to a loan account. FMS has indicated in the NPRM that it does not intend to accept this NACHA Rule with respect to benefit payments.

In addition to preempting the provisions of the NACHA Rules listed above, Part 210 would also establish, as a matter of Federal law, certain rights and obligations that are not addressed in the NACHA Rules. As noted above, the NACHA Rules generally do not address directly the rights and liabilities between receivers and originators, nor do the NACHA Rules address directly rights and liabilities between ODFIs and originators, or between RDFIs and receivers. Under the NACHA Rules, an ODFI is responsible for entries originated by its customers. The ODFI must make certain warranties with respect to any entry originated by its customer, and is liable for breach of those warranties. The ODFI's ability to seek recourse against the originator in the event of a loss for which the ODFI is liable under the NACHA Rules is generally beyond the scope of the NACHA Rules and would typically be governed by the contract between the ODFI and originator and applicable law.

FMS is proposing to establish some of these rights in Part 210 with respect to Federal agencies vis-a-vis originators or receivers of Government entries. For example, proposed Part 210 provides that a Federal agency would be liable to a recipient for any loss sustained by the recipient as a result of the Federal agency's failure to originate a credit or debit entry in accordance with Part 210, but limits that liability to the amount of the entry.

> **NACHA Response:** NACHA takes no position as to whether FMS should incorporate into Part 210 the types of accounts covered by the NACHA rule that takes effect in March 1999. With respect to addressing directly rights and liabilities between ODFIs and originators, or between RDFIs and receivers, as stated above under "Full Preemption," we recognize the need to bind originators and/or receivers of Government entries through the regulation, as opposed to negotiating separate arrangements with each Federal agency, Federal program, or Federal payment recipient.

OTHER ISSUES

In the NPRM, FMS is soliciting comment on three issues of general interest: vendor payments, automated enrollment, and automated reclamations. We also choose to respond to FMS' proposed adoption of the NACHA Rules as in effect on September 19, 1997 and its proposed process for amending 31 CFR 210 in response to subsequent changes to the NACHA Rules.

Vendor Payments

Although FMS has encouraged companies doing business with Federal agencies to receive payment through the ACH Network, participation by vendors has been low. Of the 16 million vendor payments disbursed by Treasury in fiscal year 1997, only 27% were made by EFT. FMS is seeking public comment on this matter and on what actions could be taken, in particular by the financial services/banking industry, to make improvements. Specifically, FMS seeks responses to the following questions.

What factors contribute to the non-receipt of remittance data?

NACHA Response: The payment of vendors (and grant recipients) under the Federal EFT Mandate will impact thousands of financial institutions and as many as 500,000 businesses/organizations nationwide. To ensure that this impact represents minimal disruption to the payments system and offers benefits to all participants, it is imperative that the Federal Government coordinate with and rely to the greatest possible extent on the private-sector to ensure full implementation of the final rule. This includes adherence to EFT payment policies that recognize existing technology and banking industry conventions, and that depend on established payment and information processing systems. By adopting the proposed rule recognizing the NACHA Rules, FMS will be eliminating a major hindrance to financial institution and vendor acceptance of EFT as the means of payment for Federal obligations, and of financial electronic data interchange (EDI) as the means to link these payments with the necessary remittance data.

Other factors traditionally hindering widespread acceptance of financial EDI include processing costs borne by financial institutions and vendors. With respect to vendors, much of the cost of financial EDI is in the reconciliation of the payment and its related remittance data. Currently, the capability exists to transmit payment and payment-related information in forms that permit a linkage on the receiving end. According to a 1995 NACHA financial EDI study, 84.6 percent of respondents preferred to keep dollars and data together when receiving financial EDI payments. When different networks are used -- one network for processing the payment through the banking industry and an entirely separate network for processing its related information, financial EDI can, in our view, be needlessly complex and less efficient than processing payments and payment-related information through the same network. In recognition of this, the banking industry has recently taken a number of steps to facilitate the linking of payment-related information with EFT transactions through bank-owned or operated networks.

What are the key reasons why EDI has not been adopted widely by the financial industry?

NACHA Response: The majority of Federal vendor payments still being made by check represent payments to small and medium-sized businesses whose financial institutions may not

be EDI-capable. For those financial institutions that do offer their corporate receivers remittance delivery services, many have done so as a result of customer demand, and many have been able to showcase remittance delivery information as a value-added service. Conversely, other financial institutions have opted not to offer financial EDI services because they have been unable to make a business case for investing in the necessary software.

To close this gap, NACHA has been actively establishing minimum capabilities in the ACH Network. FMS is familiar with two recently approved amendments to the NACHA Rules -- required remittance information processing for RDFIs, and an expanded automated enrollment capability (see below). In our view, both rule changes greatly enhance the attractiveness of Federal financial EDI and recognize that small and medium-sized businesses and financial institutions require access to low-cost and non-disruptive financial EDI solutions before a suitable business case exists.

The NACHA rule change ensuring a minimum financial EDI processing capacity throughout the banking industry was only made possible by the availability of low cost remittance information translation and delivery solutions to financial institutions. For example, the Federal Reserve Banks will soon make available to all financial institutions accessing Federal Reserve services a low cost remittance data processing capability. Low cost financial EDI processing applications are also available from, or being developed by, several companies that produce ACH processing software for the banking industry.

Furthermore, NACHA anticipates that the benefits of the remittance information rule change will reach well beyond commerce with the Federal Government. For example, businesses receiving payments from state and local governments will be assured of receiving remittance information sent with an ACH payment by requesting it from their financial institution. In addition this rule change will facilitate corporate-to-corporate payments by assuring that corporate receivers can request to receive payment-related information transmitted to them from corporate originators.

Does the approved amendment to the NACHA Rules, which requires the RDFI to provide remittance information upon request, adequately address vendors' concerns?

NACHA Response: Yes, we are confident that financial institution compliance with the NACHA remittance processing rule will indeed address vendor concerns. In developing and approving the remittance information processing requirement under the NACHA Rules, NACHA consulted with vendors, financial institutions and Federal agency originators. The effective date of September 18, 1998 was selected in large part to provide time for the implementation of the rule change by DFIs in advance of the January 1, 1999 effective date of the Federal EFT Mandate. For financial institutions that intend to rely on the remittance processing software to be offered by the Federal Reserve Banks, there remains the practical

issue of whether this capability will be available and widely installed by these dates. However, it is our understanding that the software will be available and installed at these institutions before year-end.

What alternative approaches/solutions are there to remedy this problem?

NACHA Response: Between the remittance delivery processing software about to be introduced by the Federal Reserve Banks and other private sector alternatives, we believe there will be suitable availability of low-cost remittance processing software for all financial institutions.

Automated Enrollment

With respect to enrollments, FMS seeks public comment on how to expand the use of automated enrollment and what steps the Federal Government could take to improve the process.

NACHA Response: The automated enrollment process was incorporated into the NACHA Rules in September 1996 for use by Federal Government agencies as a mechanism for accepting consumer credit enrollment information. However, until recently, use of the automated enrollment process was restricted under the NACHA Rules and by practice to Federal Government consumer credit application enrollments only.

Based on the earlier success of the limited ENR application and an assessment that ENR could be applied to a full range of government payment applications, NACHA recently approved a rule change expanding the availability of the automated enrollment process for Federal Government applications. Use of ENR is now available to process enrollments for both credit and debit applications for both consumers and companies. Nonetheless, it remains the Federal Government's option to commit to using this format for such applications as EFTPS and vendor enrollments. Depending on whether financial institutions choose to offer automated enrollment services, this rule change would effectively allow Federal agencies to utilize the ENR format as an optional method of consumer/corporate, debit/credit enrollment.

In developing the expanded ENR application under the NACHA Rules, NACHA conducted a survey indicating strong support:

-- 87% of all respondents to NACHA's request for comment agreed with the recommendation to expand the automated enrollment process so that it may be used by any Federal Government agency to enroll both consumers and corporations for both credit and debit applications.

-- 73% of RDFIs responding agreed that there is benefit in expanding the use of the

automated enrollment process for vendor, tax, and other Government applications.

-- 100% of Originators responding agreed that they would benefit from the automated enrollment process if it were extended to include enrollments for ACH debit applications.

-- 77% of Originators responding agreed that they would benefit from the automated enrollment process if it were extended to include enrollments for Federal Government corporate applications (i.e., vendor and tax payments).

-- 67% of Originators responding indicated an interest in utilizing the automated enrollment process if it were extended to include all Federal Government payment applications.

As with the remittance processing rule change, the expanded ENR application takes effect September 18, 1998.

NACHA strongly encourages all Federal agencies to embrace ENR to support their government payment relationships. Federal agencies would benefit from offering automated enrollment from the increased comfort level in the receipt of accurate banking information, and the decreased paper work, data entry, errors related to data entry, etc that would result.

NACHA is also working with its regional ACH associations to encourage DFIs to offer ENR initiation services to their customers. DFIs initiating ENR entries for vendor payment relationships would benefit through opportunities to build stronger account relationships with corporate customers. Also, accuracy on future payments is better assured from correct account information being transmitted/verified in the automated enrollment entry by the DFI. However, DFI acceptance will ultimately depend largely on the range of government payment applications that accept automated enrollments.

Automated Reclamation

FMS proposes in the NPRM to reorganize and rewrite Subpart B in order to allow for the increasing use of automated processes to effect reclamations, rather than requiring reclamations to be conducted on the basis of paper-driven procedures. FMS also is seeking to clarify the obligations and liabilities imposed on financial institutions under current Subpart B. FMS is not proposing to change significantly those obligations and liabilities at this time. However, FMS is considering ways in which the reclamation process might be restructured in the future to operate more efficiently as a fully automated process. FMS indicates that, because many Federal agencies are not currently in a position to move to an automated reclamation process, proposed Subpart B would preserve the basic structure of the current paper-oriented process.

According to FMS, the current reclamation process is a cumbersome and labor-intensive manual process involving a complicated formula for the allocation of liability. As the volume of Federal

benefit payments made through the ACH Network increases, the number of reclamations also will increase. FMS expects that this will increase the processing burden on both the Federal Government and financial institutions. FMS believes it would be in the best interests of the Federal Government and financial institutions to develop a more cost-effective and efficient reclamation process by simplifying the formula for allocating liability and eliminating the manual processing requirements upon which the current reclamation process is based.

In order to begin formulating a preliminary approach to implementing an automated reclamation process, FMS is soliciting comment on the considerations which financial institutions and Federal agencies believe are important with respect to reclamations. For example, because the average number of payments involved in a reclamation is 1.5, FMS questions whether the protection afforded to financial institutions by the limited liability provisions of Subpart B is outweighed by the processing costs of handling reclamations. FMS thus is interested in comment on an approach in which an RDFI would be liable for the amount of any post-death entries received, regardless of whether the RDFI had actual or constructive knowledge of the death. This liability structure would make it possible to streamline the reclamation process by eliminating the certification and informational requirements, thereby eliminating the need for the Federal Government and financial institutions to research and verify the circumstances of each reclamation.

NACHA Response: As noted above, we defer to the responses from financial institutions as to whether it is in their best interest -- given their own assessment of any reclamation processing cost savings they may expect to realize -- to accept greater liability as suggested by FMS in the NPRM.

NACHA Rule Changes and 31 CFR Part 210

Proposed 31 CFR Part 210 would incorporate the NACHA Rules in effect as of September 19, 1997, as modified by the regulation. Changes to the NACHA Rules after this date would not apply to Government entries unless FMS expressly accepts such changes by publishing notice of acceptance in the Federal Register. Finally, proposed Sec. 210.3(b)(2) provides that with respect to any future NACHA Rules changes that FMS determines to accept, the date of applicability of the amendment to Government entries would be the effective date of the rulemaking specified by FMS in the Federal Register document that expressly accepts the amendment.

NACHA Response: We believe that the process proposed by FMS to recognize future NACHA Rules changes in 31 CFR 210 would be cumbersome and confusing to ACH participants. Many NACHA Rules changes require modifications to processing software and/or handling requirements, and any delay or failure to implement such changes for Government entries would impose a dual or exception processing routine for ACH participants. Since uniformity with private sector practices in the processing of ACH payments is the primary objective of the proposed changes to 31 CFR Part 210, NACHA believes that FMS must reconsider the means by which it incorporates NACHA Rules changes

into the rule for Government entries.

To ensure that FMS' objective of "reduc[ing] the regulatory burden on financial institutions which otherwise might have to comply with conflicting or duplicative requirements" is preserved in perpetuity, NACHA strongly recommends that FMS adopt under 31 CFR Part 210 a provision whereby all NACHA Rules changes are automatically adopted under the rule (and with the same effective date associated with each change). In recognition that there may be NACHA Rules changes that either would not apply to Government entries, or would entail some consideration meriting full or partial preemption of the NACHA Rules, such a provision would also provide that FMS issue an NPRM presenting its justification as to why the NACHA Rule change should not apply to Government entries.

Finally, FMS discusses in several places in the NPRM its intent to move a number of "procedural" provisions to the Treasury Financial Manual or the Green Book. Aside from the question of how certain provisions will be determined as "procedural" vs. "substantive" in nature, FMS must be aware that the public will require adequate advanced notice and full disclosure of these changes. As companies and financial institutions become increasing automated, sufficient notice to permit software modifications and staff training is essential.

* * * * *

NACHA and its members are committed to implementing the NACHA Rules for government ACH payments, expanding the use of automated enrollment, and improving the reclamation process. We shall continue to work closely with FMS and other Federal agencies in this regard, and encourage FMS to continue its long-standing commitment to participation in the NACHA rulemaking process. We are also encouraged by the steps the government has already taken, including the general framework of the proposed rule and the clear recognition of the need to impose universal rules on both public and private sector users of the ACH Network. If you have any questions regarding our comments, please do not hesitate to call me at (703) 834-2378.

Sincerely,

Ian W. Macoy
Senior Director, Government Relations

L:\WPWDATA\GOVTREL\COMMENTS\31CFR210.DOC